

BEFORE THE STATE TAX APPEAL BOARD

OF THE STATE OF MONTANA

ROBERT J. THUESEN,)	
)	DOCKET NO.: IT-2000-2
Appellant,)	
)	
-vs-)	FACTUAL BACKGROUND,
)	CONCLUSIONS OF LAW,
THE DEPARTMENT OF REVENUE)	ORDER and OPPORTUNITY
OF THE STATE OF MONTANA,)	<u>FOR JUDICIAL REVIEW</u>
)	
Respondent.)	

The above-entitled appeal was heard on April 25, 2001, in the City of Billings, Montana, in accordance with an order of the State Tax Appeal Board of the State of Montana (the Board). The notice of the hearing was duly given as required by law.

The taxpayer, Robert Thuesen, presented testimony in support of the appeal. The Department of Revenue (DOR), represented by Tax Counsel Charlena Toro and Tax Auditor Edwina Rose, presented testimony in opposition to the appeal. Testimony was presented and exhibits were received. The Board allowed the record to remain open for a period of time for the purpose of receiving post-hearing submissions. Mr. Thuesen is the appellant in this proceeding and, therefore, has the burden of proof. Based on the evidence, testimony, and post-hearing submissions, the Board finds

that the decision of the Department of Revenue shall be modified.

STATEMENT OF THE ISSUE

The taxpayer received severance pay on September 2, 1998 in the amount of \$76,175. This amount was included in his 1998 compensation amount reported on line 17 of the taxpayer's W-2 form (\$133,651.94). The employer withheld \$7,069.34 for Montana individual income tax. The question before this Board is: should severance pay, received by the taxpayer in 1998, be included in the taxpayer's Montana taxable income reported on Schedule IV of his 1998 Montana Individual Income Tax Return when computing his prorated Montana tax liability?

FACTUAL BACKGROUND

1. Due, proper and sufficient notice was given of this matter, the hearing hereon, and of the time and place of the hearing. All parties were afforded opportunity to present evidence, oral and documentary.

2. Mr. Thuesen timely filed a 1998 nonresident Montana individual income tax return on March 5, 1999.

3. A DOR error resolution sheet was generated during the routine examination of the subject return.

4. Julie Waples, a DOR auditor, was assigned the duty of reconciling the error resolution sheet.

5. In a letter dated April 23, 1999, (Taxpayer's Exhibit 4) Ms. Waples notified Mr. Thuesen that she had adjusted the subject 1998 tax return for the reason that "Your severance pay is directly related to income earned in Montana, therefore it is taxable to Montana." She issued an additional assessment in the amount of \$3,840. (An additional issue of a capital gain split was referenced in this letter. Mr. Thuesen's testimony at the hearing before this Board that this issue had been resolved.)

6. Correspondence from the taxpayer to the DOR in April and May of 1999 indicated that he objected to the DOR's additional assessment because the severance pay at issue was neither related to time worked in Montana nor to the location of the work performed. Further, he contended that the severance pay was related only to the number of years of service with his employer, Peter Kiewit and Sons, Inc., and to his age at the time he terminated employment with the company. Therefore, he argued that the severance pay was not directly related to income that had been earned, and taxed accordingly, in Montana and should not be further taxed by Montana.

7. Mr. Thuesen's former employer, Peter Kiewit and Sons, Inc., is a large construction and mining company with its home office in Omaha, Nebraska. The company operates

five coal mines: one in Montana, three in Wyoming, and one in Texas. At various times during Mr. Thuesen's 20¼ years of employment with the firm, he was employed at the home office in Nebraska, at the Big Horn Coal Mine and the Black Butte Coal Mine in Wyoming and at the Decker Coal Mine in Montana.

8. During 1998, the year in which the severance pay was received upon termination of employment, Mr. Thuesen was employed at the Decker Coal Mine in Decker, Montana. He resided in Sheridan, Wyoming and traveled daily to Decker, Montana to perform his work.

9. A hearing was held on January 20, 2000 in Billings, Montana before David Olsen, DOR hearing examiner.

10. The DOR hearing examiner issued his decision on this matter on March 30, 2000, upholding the DOR's conclusion that the subject severance pay was taxable to Montana.

11. Mr. Thuesen appealed the hearing examiner's decision to Mary Bryson, DOR director.

12. On July 31, 2000, Ms. Bryson issued the final agency decision on this matter which upheld the hearing examiner's conclusion.

13. Mr. Thuesen filed a timely appeal with this Board on August 16, 2000.

14. Both parties agree that the \$76,175 of severance pay, received in 1998, should be included in the taxpayer's federal gross income.

TAXPAYER'S CONTENTIONS

Mr. Thuesen was employed by Peter Kiewit and Sons, Inc., from July 31, 1978 until October 16, 1998 as a mining engineer. He testified that he worked for 14 years at Decker Coal Company in Montana and, for the remaining six years, he worked at other operations of Peter Kiewit and Sons. When his employment at Peter Kiewit and Sons, Inc., ended in 1998, he received severance pay from the company. The amount of the severance pay at issue (\$76,175) was determined from the following items: 1) number of full years of service with the firm; 2) an age multiplier; and 3) the final weekly salary. For every full year of service with the firm, Mr. Thuesen received one week's salary plus an additional two weeks' pay. Therefore, with 20 full years of service, he was entitled to 22 weeks of his final salary, which was \$1,385. This amount was adjusted by an "age multiplier" determined by his former employer (2.5). At the time of his termination in October of 1998, Mr. Thuesen was 50 years old. Therefore, the subject severance pay was determined as follows: 22 weeks X 2.5 X \$1,385.00 = \$76,175.

Mr. Thuesen discussed the capital gains split issue referenced on the DOR's original notice of assessment. While not an issue before this Board, he undertook the discussion in an effort to demonstrate a pattern of what he termed inconsistent, intimidating, misleading, discriminatory and protracted DOR action.

Mr. Thuesen also complained of inconsistent DOR treatment of similarly situated taxpayers. He compiled a list of 12 individuals, from memory, who had terminated from Decker Coal and had received severance pay from Peter Kiewit and Sons, Inc., in the years 1996, 1997, 1998 and 1999. (Taxpayer's Exhibit 10). During a pre-hearing telephonic conference held on January 23, 2001, during which Edwina Rose represented the DOR and Mr. Thuesen appeared on his behalf, Mr. Thuesen presented a list of 12 questions related to the severance pay issue and disparate treatment among similar taxpayers. Mr. Thuesen stated that he was told by the DOR that a response to most of the questions would be too burdensome and time consuming in view of the DOR staff and resource limitations and that some of the issues infringed upon confidentiality concerns. The DOR responded, however, to the taxpayer's inquiry concerning the severance pay received by the 12 former employees of Decker Coal (Taxpayer's Exhibit 10). Taxpayer's Exhibit 11 is a copy of

the April 11, 2001 DOR summary response to that question. Summarized, Exhibit 11 states that five of the 12 individuals included the severance pay on the Montana Schedule 3 and paid the appropriate amount of tax; one individual's return was adjusted when the return was reviewed and that individual paid the assessment; and six individual returns were recently adjusted (March 27, 2001) and that statements of additional assessment have been sent to those taxpayers. Mr. Thuesen noted that one of these 12 individuals did not actually receive severance pay and, therefore, Exhibit 11 contains at least two errors: 1) there are only 11, not 12, individuals who received severance pay, according to Mr. Thuesen, and 2) only four individuals included the income on their Montana Schedule 3 and paid the appropriate amount of tax.

Mr. Thuesen testified that the individual referenced in Exhibit 11 who was said to have paid the assessment after receiving an adjusted assessment is actually in the process of appealing the assessment. He also noted that at least five of the six individuals whose returns were adjusted on March 27, 2001 are "already, or shortly will be, in the appeals process."

Mr. Thuesen further charged DOR with disparate treatment because, to his knowledge, only two of the eleven

individuals, whom he knew to have received severance pay from Peter Kiewit around the time that he did, received notices of additional assessment in 1999. The majority did not receive notices of additional assessment until he drew the attention of the DOR to those individuals.

Taxpayer's Exhibit 13 are copies of letters he sent to the DOR to accompany his 1993, 1994, 1995, 1996 and 1997 returns in which he specified the dates upon which he did not work in Montana and excluded that income from consideration as taxable to Montana. Based upon these statements, Mr. Thuesen stated that the DOR has allowed him to exclude income earned outside Montana: "My returns for 1993 through 1997 were not adjusted by the Department of Revenue." Provisions for this procedure can be found in the DOR's Instructions for Schedule III & IV (Taxpayer's Exhibit 12) for the 1998 return: ". . . If you have income from Montana and from another source shown on the same schedule, you must attach a statement to the Montana return to identify the Montana income."

In 1998, Mr. Thuesen also informed the DOR that he had earned income, other than the subject severance pay, that was from outside Montana sources and, therefore, not taxable to Montana. This statement was apparently acceptable to the DOR: "The schedule III amount was computed by taking your

Montana withholding statement from Decker Coal and reducing the amount of \$1531.00 that you stated was income earned outside of Montana." (Taxpayer's Exhibit 5, April 29, 1999 letter from DOR to Mr. Thuesen - emphasis supplied.)

Mr. Thuesen testified that DOR Agent Scott Payton proposed a proration of the tax on severance pay based on weeks worked inside of Montana and weeks worked outside Montana during the course of Mr. Thuesen's employment with Peter Kiewit and Sons: "What he proposed at the time was I would pay tax on 35/55 of the severance pay. That would be the 14 weeks I worked in Montana times 2.5, 2.5 times 14 being 35, 55 being the total number of weeks, so he proposed I pay tax on 35/55 of the severance pay." Mr. Thuesen stated that he was opposed to that compromise on the grounds that he doesn't think any of the severance pay is taxable to Montana.

Mr. Thuesen's post-hearing brief, received by this Board on June 25, 2001, provided an historical background of the appeal which was consistent with that found previously in the record.

He reiterated his argument that the subject severance pay is not taxable to Montana, offering as support the following sections from administrative rule: ARM 42.16.1104 (*Earned Income Definition (1) In general- the term "earned*

income" means: (a) Wages, salaries or professional fees, and other amounts received as compensation for personal services actually rendered; - emphasis supplied) and ARM 42.16.111 (Compensation for Personal Services (1) A nonresident's compensation for personal services is derived from or attributable to sources within Montana to the extent his services were performed in Montana.

Thus, Mr. Thuesen contends that the only nonresident compensation that is derived from or attributed to sources within Montana, and therefore taxable by Montana, is that portion that is compensation for personal services actually performed in Montana.

He further argued that the subject severance pay is compensation for severing 20 years employment with Peter Kiewit Sons', Inc., and is not based upon services performed in any specific location.

He reiterated the disparate treatment issue discussed above concerning similarly situated taxpayers.

He provided a definition of severance pay from Black's Law Dictionary (7th ed. 1999): "**Severance pay.** Money (apart from back wages or salary) paid by an employer to a dismissed employee. Such a payment is often made in exchange for a release of any claims that the employee might

have against the employer. - Also termed *separation pay: dismissal compensation.*"

DOR'S CONTENTIONS

The salient facts in this matter are: 1) Mr. Thuesen was employed by Peter Kiewit and Sons from July of 1978 to October 1998. 2) He worked at Decker Coal in 1998. 3) He resided in Sheridan, Wyoming in 1998. 4) He filed individual income tax returns in Montana when he worked at the Decker coal mine. 5) In 1998, his employment was terminated with Peter Kiewit and Sons, Inc. 6) In 1998, he received severance pay in the amount of \$76,175. 7) In 1998, Decker Coal withheld tax from Mr. Thuesen and this was reflected on his W-2 form. 8) Mr. Thuesen sought a refund because he did not include his severance pay on his 1998 Montana income tax return. 9) When the 1998 tax return was received by the DOR, an error dispute resolution sheet was generated, which prompted a manual review of Mr. Thuesen's return. 10) Based on that manual review, an auditor issued an assessment to Mr. Thuesen in the amount of \$3,840. 11) Mr. Thuesen disputed the determination, claiming that severance pay was not based on employment, rather, on his years of service, age multiplier, and final weekly salary. 12) The DOR maintains that the severance pay calculation explains only the amount of the severance and does not have relevance to

any determination as to whether or not the severance pay is attributable to Montana sources. 13) The proper analysis contains the realization that severance pay is compensation. DOR Exhibit A is a copy of Title 26 of the Internal Revenue Service Code (Section 1.61-2). In pertinent part, this code provides:

. . . (a) In general. (1) Wages, salaries . . . termination or severance pay . . . are income to the recipients unless excluded by law . . . (Emphasis supplied).

14) The only issue before the Board is whether the subject severance pay is attributable to Montana sources. A nonresident's income is attributable to Montana sources if the services were performed in Montana. (ARM 42.16.1111 and 15-30-105, MCA.) Mr. Thuesen performed services in Montana in 1998. He received his severance pay from Peter Kiewit and Sons, Inc., in 1998 for services performed. In fact, but for his employment in 1998 at the Decker Coal Mine, he would not even have been entitled to his severance pay. Both his wages and severance pay, in 1998, are attributable to Montana sources. Because the wages and severance pay were received in 1998, that is the determinative factor for when those wages or severance pay are taxable to Montana. According to Internal Revenue Code 451-A, which states that income is taxable in the year in which it was actually

received. There is absolutely no basis in law for the apportionment of such severance pay.

DOR Tax Auditor Edwina Rose testified that she became involved in this case because, after Mr. Payton had reviewed the information related to a request for hearing, it became her responsibility to refer the matter to her supervisor and, ultimately, to the Office of Dispute Resolution.

She emphasized that the W-2 form (Taxpayer's Exhibit 1, page 2) reports the entire amount of income received by the taxpayer in 1998, which would include the subject severance pay as well as 1998 wages received.

The audit of this return was prompted by an error resolution sheet generated by the computer because of the dollar amount requested as a refund going out of state.

Ms. Rose audited the returns of 12 individuals in response to information supplied by Mr. Thuesen relating to those individuals that he believed were recipients of severance pay from Decker Coal during tax years 1996 through 1999. Of these 12 individuals, Ms. Rose found that five individuals included the income on their Montana returns and computed and paid the appropriate amount of tax. One individual's assessment was adjusted "about the same time that Mr. Thuesen was." That individual paid the assessment in order to avoid further charges of penalty and/or

interest. The remaining returns were recently adjusted and letters and statements of account have been sent, stating that the severance income should have been included in Montana taxable income. She acknowledged that at least one individual is awaiting the outcome of the present case in anticipation of filing an appeal.

In response to Mr. Thuesen's concerns, Ms. Rose testified that he was not treated any differently than any other individual, or singled out in any way throughout the course of this dispute. She stated that there are many returns, because they are mathematically correct, that do not prompt an error resolution sheet "even though there might be something wrong with them." Those returns that do prompt a closer review may not meet parameters that have been programmed into the DOR's computer system.

Ms. Rose also acknowledged that an audit can, and does, occur purely by "chance."

The DOR's post-hearing brief reiterated its position income tax was properly imposed upon Mr. Thuesen for severance pay because he received that income while working for Decker in Montana as provided by Section 15-30-105, MCA and ARM 42.16.1111. Pursuant to IRC Section 451 (a), the subject severance pay must be included in the taxpayer's

gross income for 1998 because that was the year in which it was actually received.

BOARD'S DISCUSSION

A nonresident's income is attributable to Montana when that nonresident performs services in Montana. Mr. Thuesen performed services in Montana in 1998 and received wages and severance pay in 1998 for those services performed. As a result, that income is attributable to Montana sources and is taxable to Montana in 1998 pursuant to Section 15-30-105 (1), MCA, and ARM 42.16.1111. Title 26 of the Internal Revenue Service Code (Section 1.61-2) defines severance pay as compensation or income. Thus, the Board upholds the DOR determination that the subject severance pay is attributable to Montana sources and is, therefore, taxable to Montana.

The DOR has satisfactorily demonstrated that it did not discriminate against Mr. Thuesen. The proceedings may have been protracted but that circumstance was most likely related to staffing and resource shortfalls within the DOR.

The DOR's position was that Scott Payton's offer of compromise took place through a merely hypothetical conversation in which Mr. Payton was considering potential ways that might be fair in an attempt to come to some sort of agreement and that Mr. Payton did not possess settlement authority. However, Taxpayer's Exhibit 13 demonstrated to

this Board that Mr. Thuesen's statement of income not attributable to Montana was sufficient for the DOR for tax years 1993, 1994, 1995, 1996 and 1997. The DOR deducted that non-Montana income from the taxpayer's liability for those years. It acted in the same manner via the April 29, 1999 letter from Julie Waples to Mr. Thuesen when she stated that the amount of income earned outside Montana (\$1,531) would reduce Mr. Thuesen's tax liability to Montana (Taxpayer's Exhibit 5). When Mr. Thuesen provided a statement of non-Montana income, the DOR reduced his Montana liability accordingly.

Mr. Thuesen has provided this Board with a similar statement regarding his years of Montana-based employment. The Board sees merit in accepting the "offer of compromise" which Mr. Thuesen referenced, under oath. Mr. Payton, a DOR agent, proposed a proration of the tax on severance pay based on weeks worked in Montana and weeks worked outside Montana during Mr. Thuesen's employment with Peter Kiewit and Sons. Based on the formula used by Mr. Thuesen's former employer, Mr. Payton proposed subjecting a tax liability on the subject severance pay to 14 of the 20 years for which Mr. Thuesen worked for Peter Kiewit and Sons, Inc., which equated to 35 of the 55 weeks upon which the severance pay amount was based. The Board will accept that proration and

will order the subject tax liability to be recalculated using the 35/55 ratio. Applying this ratio should subject approximately 64 percent of the severance pay at issue to taxation by Montana (35/55, or .636364, times \$76,175), resulting in \$48,475.

CONCLUSIONS OF LAW

1. **§15-2-302, MCA. Direct appeal from department decision to state tax appeal board - hearing.** (2)(a) Except as provided in subsection (2)(b), the appeal is made by filing a complaint with the board within 30 days following receipt of notice of the department's final decision.

2. **ARM 42.16.1111. Compensation for personal services.** (1) A nonresident's compensation for personal services is derived from or attributable to sources within Montana to the extent his services were performed in Montana.

3. **§15-30-105, MCA. Tax on nonresident** (1) A tax on income earned in Montana is imposed upon each person not a resident of this state . . . After calculating the tax imposed, the tax due and payable must be determined based upon the ratio of income earned in Montana to total income.

4. The appeal of the taxpayer is hereby granted in part and denied in part and the decision of the Department of Revenue is modified.

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ORDER

IT IS THEREFORE ORDERED by the State Tax Appeal Board of the State of Montana that the subject assessment shall be modified to reflect the prorated tax discussed above.

Dated this 26th day of June, 2001.

BY ORDER OF THE
STATE TAX APPEAL BOARD

(S E A L)

GREGORY A. THORNQUIST, Chairman

JERE ANN NELSON, Member

LARRY L. BROWN, Member

NOTICE: You are entitled to judicial review of this Order in accordance with Section 15-2-303(2), MCA. Judicial review may be obtained by filing a petition in district court within 60 days following the service of this Order.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 26th day of June, 2001, the foregoing Order of the Board was served on the parties hereto by depositing a copy thereof in the U.S. Mails, postage prepaid, addressed to the parties as follows:

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